



**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Financial Statements

June 30, 2013 and 2012

(With Independent Auditors' Report Thereon)



KPMG LLP
2500 Ruan Center
666 Grand Avenue
Des Moines, IA 50309

Independent Auditors' Report

The Board of Regents
State of Iowa:

We have audited the accompanying financial statements of the State University of Iowa, University of Iowa Hospitals and Clinics (UIHC), which comprise the statements of net position as of June 30, 2013 and 2012, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of the State University of Iowa, University of Iowa Hospitals and Clinics as of June 30, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Other Matters

As discussed in note 1 to the financial statements, the financial statements of UIHC are intended to present the financial position and the changes in financial position and cash flows of only that portion of the business type activities of the State University of Iowa that is attributable to the transactions of UIHC. UIHC is a department of the State University of Iowa for financial reporting purposes. The financial statements of UIHC do not purport to, and do not, present fairly the financial position of the State University of Iowa as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3-8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

/s/ KPMG LLP

November 8, 2013
Des Moines, Iowa

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Management's Discussion and Analysis

June 30, 2013 and 2012

Introduction

This section of the State University of Iowa, University of Iowa Hospitals and Clinics' (UIHC) annual financial report presents management's discussion and analysis of UIHC's financial performance during the years ended June 30, 2013 and 2012. The purpose is to provide an objective analysis of the financial activities of UIHC based on currently known facts, decisions, and conditions. Please read it in conjunction with UIHC's financial statements and the accompanying notes to the financial statements.

Financial Highlights

UIHC demonstrated financial success in 2013, with an increase in net position of \$10.2 million, or 0.9%, as compared to an increase in net position in 2012 by \$54.9 million, or 5.0%. Operating income in 2013 was \$39.0 million, a decrease of \$7.7 million when compared to 2012. Nonoperating revenues and expenses decreased \$3.4 million. Operating income in 2012 was \$46.7 million, a decrease of \$13.6 million when compared to 2011. Nonoperating revenues and expenses in 2012 decreased \$7.2 million from 2011.

Overview of the Financial Statements

This annual report consists of two parts – management's discussion and analysis and the basic financial statements.

The financial statements consist of three statements – statements of net position; statements of revenues, expenses, and changes in net position; and statements of cash flows. These financial statements and related notes provide information about the activities of UIHC and have been prepared on an accrual basis in accordance with Governmental Accounting Standards Board (GASB) accounting principles.

Statements of Net Position and Statements of Revenues, Expenses, and Changes in Net Position

In 2013, net position increased by \$10.2 million, or approximately 0.9%, to \$1.2 billion. This is primarily due to net income from operations of \$39.0 million. In 2012, net position increased by \$54.9 million, or more than 5.0%, to \$1.2 billion. This is primarily due to net income from operations of \$46.7 million.

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Table 1 provides a summary of UIHC's assets, liabilities, and net position as of June 30, 2013, 2012, and 2011.

**Table 1
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Condensed Statements of Net Position

(In thousands)

Assets	2013	2012	2011
Current assets	\$ 349,550	343,791	303,528
Noncurrent cash and investments	781,560	607,919	606,578
Capital assets, net	634,785	566,046	507,357
Other assets	5,948	4,073	3,370
Total assets	\$ 1,771,843	1,521,829	1,420,833
Liabilities			
Current liabilities	\$ 176,522	157,574	125,438
Long-term debt	384,912	168,970	147,276
Other long-term liabilities	38,227	33,297	41,080
Total liabilities	599,661	359,841	313,794
Net position:			
Net investment in capital assets	427,713	430,869	368,302
Restricted	8,411	5,707	17,176
Unrestricted	736,058	725,412	721,561
Total net position	1,172,182	1,161,988	1,107,039
Total liabilities and net position	\$ 1,771,843	1,521,829	1,420,833

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Table 2 shows the changes in net position for 2013 compared to 2012 and 2011.

Table 2
UNIVERSITY OF IOWA HOSPITALS AND CLINICS
Statements of Revenues, Expenses, and Changes in Net Position
(In thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating revenues:			
Net patient service revenue	\$ 1,072,224	1,041,179	988,234
Other revenue	53,112	57,114	45,214
Total operating revenues	<u>1,125,336</u>	<u>1,098,293</u>	<u>1,033,448</u>
Operating expenses:			
Salaries and benefits	563,686	546,771	488,546
Medical supplies and drugs	222,991	222,447	202,779
Other supplies and general expenses	227,034	212,655	211,714
Depreciation and amortization	72,671	69,724	70,062
Total operating expenses	<u>1,086,382</u>	<u>1,051,597</u>	<u>973,101</u>
Operating income	<u>38,954</u>	<u>46,696</u>	<u>60,347</u>
Nonoperating revenues (expenses):			
Gain (loss) on disposal of capital assets	(614)	851	(8,420)
Noncapital gifts	2,530	354	4,507
Investment income	22,688	24,243	37,472
Interest expense	(6,635)	(4,051)	(5,008)
Total nonoperating revenues, net	<u>17,969</u>	<u>21,397</u>	<u>28,551</u>
Excess of revenues over expenses before transfers	56,923	68,093	88,898
Capital gifts and grants	20	2,323	—
Net transfers out	(46,749)	(15,467)	(2,955)
Increase in net position	10,194	54,949	85,943
Net position, beginning of year	<u>1,161,988</u>	<u>1,107,039</u>	<u>1,021,096</u>
Net position, end of year	<u>\$ 1,172,182</u>	<u>1,161,988</u>	<u>1,107,039</u>

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Net Patient Service Revenue

Net patient service revenue increased from 2012 to 2013 by \$31 million, or 3.0%, and \$52.9 million, or 5.4%, from 2011 to 2012. The increases in net patient service revenue were driven by both increases in patient volumes and pricing increases during the same periods. The increase in 2013 resulted from increases in outpatient areas. There was an increase in outpatient clinic visits from 2012 to 2013 by 19,893, or 2.4%, and an increase in outpatient surgeries of 891, or 5.4%. On the inpatient side, acute admissions were down 193, or 0.6%, under 2012 and inpatient surgeries decreased by 102, or 0.9%. The increase in 2012 resulted from increases in both the inpatient and outpatient areas. On the inpatient side, acute admissions were up 588, or 2.0%, over 2011 and inpatient surgeries increased by 249, or 2.2%. There was also an increase in outpatient clinic visits from 2011 to 2012 by 39,389, or 5.1%, and an increase in outpatient surgeries of 925, or 6.0%.

The provision for bad debts (a deduction from gross patient charges) decreased \$1.0 million from \$26 million in 2012 to \$25 million in 2013. The provision for bad debts (a deduction from gross patient charges) increased \$3.4 million from \$22.6 million in 2011 to \$26.0 million in 2012.

Operating Expenses

Total operating expenses increased 3.3% from \$1.05 billion in 2012 to \$1.09 billion in 2013. The largest dollar increase in expenses in 2013 was in salaries and benefits, which increased \$16.9 million, or 3.1%, when compared to 2012. In addition, other supplies and general expenses increased \$14.4 million, or 6.8%, in 2013 compared with 2012. The increase in other supplies and general expenses was caused by an increase in medical services expense which increased \$10.8 million, or 14.8% compared with 2012.

Total operating expenses increased 8.1% from \$973.1 million in 2011 to \$1.05 billion in 2012. The largest increase in expenses in 2012 was in salaries and wages, which increased \$30.0 million, or 8.3%, when compared to 2011. In addition, employee benefit expenses increased \$28.3 million. The increase in personnel expenses was caused by increased employee counts to keep pace with increased volumes and additional liabilities for compensated absences. Drug expenses increased \$10.1 million, or 12.7%, in 2012 compared with 2011. Drug expenses increased with the addition of the Cancer Center and an increase in hemophilia drugs compared with 2011.

Nonoperating Revenues and Expenses, Net

Nonoperating revenues consist primarily of gains (losses) on disposals of capital assets, investment income, interest expense, and noncapital gifts. Investment income decreased from 2012 to 2013 by \$1.5 million, or 6.4%, and decreased from 2011 to 2012 by \$13.3 million, or 35.3%. During 2013, UIHC recorded overall earnings on the endowment and operating pools of \$19.4 million and a net unrealized gain on investments of \$3.3 million, which increased investment income accordingly. This compares to the overall earnings on the endowment and operating pools of \$13.7 million and a net unrealized gain on investments of \$10.5 million in the previous year.

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Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities. UIHC's overall liquidity increased during 2013, with a net increase in cash and cash equivalents of \$0.3 million. In 2013, net cash from operating activities provided cash inflows of \$131.5 million and net cash used in noncapital financing was \$44.2 million. UIHC's overall liquidity increased during 2012, with a net increase in cash and cash equivalents of \$0.4 million. In 2012, net cash from operating activities provided cash inflows of \$120.5 million and net cash used in noncapital financing was \$15.1 million. UIHC's overall liquidity increased during 2011, with a net increase in cash and cash equivalents of \$0.5 million.

Capital Assets and Debt Administration

Capital Assets

At the end of 2013, UIHC had \$634.7 million invested in capital assets, net of accumulated depreciation. This is a \$68.7 million increase when compared to capital assets, net in 2012 of \$566.0 million. This increase is primarily due to spending on the Iowa River Landing project and UIHC Children's Hospital. Capital assets, net of accumulated depreciation increased \$58.6 million in 2012 when compared to capital assets, net in 2011 of \$507.4 million.

The major capital asset additions in 2012 and 2013 included the following:

- UIHC Children's Hospital
- Iowa River Landing
- Ambulatory Surgery Center and Operating Room Expansion
- Cardiovascular Intensive Care Unit Renovation
- North Liberty Land Purchase
- Data Center

Debt

At June 30, 2013 and 2012, UIHC had \$393.0 million and \$174.8 million, respectively, in bonds and capital lease outstanding. During 2013 and 2012, payments of long-term debt were \$5.9 million and \$24.4 million, respectively.

During 2013, UIHC issued \$190 million of Series S.U.I. 2012 Hospital Revenue Bonds. The proceeds of the Bonds will be used to construct, improve, remodel, repair, furnish, and equip a new children's hospital at the University of Iowa Hospitals and Clinics on the campus of The State University of Iowa, to fund a debt service reserve fund, and to pay the costs of issuing the Bonds. In addition, during 2013, UIHC entered into a capital lease arrangement relating to parking facilities at Iowa River Landing site.

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During 2012, UIHC issued \$26.8 million of Series S.U.I. 2011 Hospital Revenue Bonds. The proceeds of the Bonds were used by the UIHC for the costs of constructing, improving, remodeling, repairing, furnishing, and equipping inpatient and outpatient care facilities, including construction of a new medical office building and related space, including finish materials, fixtures, furnishings, equipment, and appliances, funding a deposit to the Reserve Fund, and paying the costs of issuance of the Bonds. UIHC also issued \$20.4 million of Series S.U.I. 2011A Hospital Revenue Refunding Bonds in 2012. The proceeds of the Bonds were used to refund the Series 2002 Hospital Revenue Bonds.

Contacting UIHC's Financial Management

This financial report provides the citizens of Iowa, UIHC patients, bondholders, and creditors with a general overview of UIHC's finances and operations. If you have questions about this report, please contact Mr. Kenneth L. Fisher, Associate Vice President for Finance, UI Healthcare and CFO, University of Iowa Hospitals and Clinics, 300 CMAB, Iowa City, Iowa 52242.

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Statements of Net Position

June 30, 2013 and 2012

(In thousands)

Assets	2013	2012
Current assets:		
Cash and cash equivalents	\$ 2,129	1,819
Short-term investments	151,537	144,012
Patient accounts receivable, net of estimated uncollectibles		
\$19,709 in 2013 and \$19,124 in 2012	161,943	153,061
Inventories	19,119	20,594
Current portion of debt service funds – restricted	1,684	1,496
Other current assets	13,138	22,809
Total current assets	349,550	343,791
Noncurrent cash and investments:		
Designated by the Board of Regents	747,139	588,719
Held by trustee restricted for debt service	27,367	14,704
Restricted by contributors and grantors for capital acquisitions and research	7,054	4,496
	781,560	607,919
Capital assets, net	634,785	566,046
Other assets	5,948	4,073
Total assets	\$ 1,771,843	1,521,829
Liabilities and Net Position		
Current liabilities:		
Current maturities of long-term debt	\$ 8,133	5,818
Accounts payable and accrued expenses	116,327	117,188
Estimated third-party payor settlements	39,766	22,146
Due to related parties	2,021	4,122
Other current liabilities	5,245	5,133
Accrued interest	5,030	3,167
Total current liabilities	176,522	157,574
Long-term debt, net of current maturities	384,912	168,970
Other long-term liabilities	38,227	33,297
Total liabilities	599,661	359,841
Net position:		
Net investment in capital assets	427,713	430,869
Restricted by donors for specific purposes	6,727	4,211
Restricted for debt service	1,684	1,496
Unrestricted	736,058	725,412
Total net position	1,172,182	1,161,988
Total liabilities and net position	\$ 1,771,843	1,521,829

See accompanying notes to financial statements.

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Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2013 and 2012

(In thousands)

	2013	2012
Operating revenues:		
Net patient service revenue, net of provision for bad debts of \$24,940 in 2013 and \$25,990 in 2012	\$ 1,072,224	1,041,179
Other revenue	53,112	57,114
Total operating revenues	1,125,336	1,098,293
Operating expenses:		
Salaries and benefits	563,686	546,771
Medical supplies and drugs	222,991	222,447
Other supplies and general expenses	227,034	212,655
Depreciation and amortization	72,671	69,724
Total operating expenses	1,086,382	1,051,597
Operating income	38,954	46,696
Nonoperating revenues (expenses):		
Gain (loss) on disposal of capital assets	(614)	851
Noncapital gifts	2,530	354
Investment income	22,688	24,243
Interest expense	(6,635)	(4,051)
Total nonoperating revenues, net	17,969	21,397
Excess of revenues over expenses before transfers	56,923	68,093
Capital gifts and grants	20	2,323
Net transfers out	(46,749)	(15,467)
Increase in net position	10,194	54,949
Net position, beginning of year	1,161,988	1,107,039
Net position, end of year	\$ 1,172,182	1,161,988

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended June 30, 2013 and 2012

(In thousands)

	2013	2012
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 1,080,963	1,030,093
Other receipts	51,011	55,830
Payments to employees	(555,040)	(534,360)
Payments to suppliers and contractors	(445,408)	(431,055)
Net cash provided by operating activities	131,526	120,508
Cash flows from noncapital financing activities:		
Net transfers	(46,749)	(15,467)
Noncapital gifts	2,530	354
Net cash used in noncapital financing activities	(44,219)	(15,113)
Cash flows from capital and related financing activities:		
Purchase of capital assets	(122,281)	(131,184)
Proceeds from the sale of capital assets	2,183	2,771
Capital gifts and grants received	20	2,323
Proceeds from the issuance of long-term debt	190,000	47,155
Premium received on issuance of long-term debt	13,516	819
Principal paid on long-term debt	(5,854)	(24,357)
Interest paid on long-term debt	(5,490)	(4,334)
Net cash provided by (used in) capital and related financing activities	72,094	(106,807)
Cash flows from investing activities:		
Proceeds from sale of investments	100,192	51,780
Purchase of investments	(278,505)	(63,810)
Interest and dividends received on investments	19,222	13,833
Net cash (used in) provided by investing activities	(159,091)	1,803
Net increase in cash and cash equivalents	310	391
Cash and cash equivalents at beginning of year	1,819	1,428
Cash and cash equivalents at end of year	\$ 2,129	1,819
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 38,954	46,696
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	72,671	69,724
Provision for bad debts	24,940	25,990
Changes in assets and liabilities:		
Accounts receivable	(33,822)	(43,375)
Inventories	1,475	835
Other assets	7,608	(2,075)
Accounts payable and accrued expenses	(861)	25,612
Other liabilities	5,042	(7,916)
Due to related parties	(2,101)	(1,282)
Estimated third-party payor settlements	17,620	6,299
Net cash provided by operating activities	\$ 131,526	120,508
Noncash investing activities:		
UIHC held cash and investments at June 30, 2013 and 2012 with a fair value of \$936,910 and \$755,246, respectively.		
During 2013 and 2012, the net increase in fair value of these investments was \$3,256 and \$10,456, respectively.		
During 2013, UIHC acquired \$22,000 of property through capital lease obligations.		

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2013 and 2012

(1) Summary of Significant Accounting Policies and Related Matters

(a) Reporting Entity

For purposes of this report, the State University of Iowa, University of Iowa Hospitals and Clinics (UIHC) includes the healthcare units of the University of Iowa, which are generally referred to as the University Hospital, the Psychiatric Hospital, and the Center for Disabilities and Development. UIHC is part of the State University of Iowa (the University), which is owned and operated by the State of Iowa under the supervision of the Board of Regents, State of Iowa (the Board) and is a University department for financial reporting purposes.

UIHC includes substantially all of the healthcare provider activities for patient care associated with the University other than the physician and dentist services and research activities provided by the faculties of the University's Colleges of Medicine and Dentistry. Student Health Services, Specialized Child Health Services outreach programs, and the University of Iowa Health System (UIHS), a UIHC affiliate, are not included in these financial statements.

UIHC is a comprehensive tertiary care referral center located in Iowa City, Iowa, offering a full range of clinical services in substantially all specialties and subspecialties of medicine and dentistry. UIHC serves as a resource for the state's primary and secondary healthcare providers. Patients are primarily from Iowa.

(b) Basis of Presentation

UIHC's financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred without regard to receipt or disbursement of cash.

UIHC adopted Governmental Accounting Standards Board (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, in 2013. The objective of this statement is to provide guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The statement was implemented retroactively and resulted in a change in presentation of the balance sheets to what is now referred to as the statements of net position and the term "net assets" is changed to "net position" throughout the financial statements. The adoption of this statement did not impact amounts reported in the financial statements.

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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(d) Cash and Investments

Cash and investments of UIHC include specific investments and other cash and investments that are pooled with the cash and investments of the University and held in the name of the University. UIHC's share of pooled investments and income thereon is determined on a pro rata basis reflecting UIHC's amounts available for investment as compared with the amounts for the overall University.

Undesignated cash equivalents totaling \$2.1 million and \$1.8 million at June 30, 2013 and 2012, respectively, represent money market funds and other short-term investments that mature in three months or less from date of purchase.

(e) Inventories

Inventories consist primarily of medical and surgical, pharmaceutical, dietary, and other supplies. Inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out or weighted average basis.

(f) Capital Assets

UIHC's capital assets are reported at historical cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land are depreciated or amortized using the straight-line method of depreciation using the following asset lives:

Buildings and leasehold improvements	10 to 40 years
Infrastructure and land improvements	5 to 20 years
Equipment and software	3 to 10 years

(g) Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

(h) Gifts and Grants

From time to time, UIHC receives grants, as well as gifts from individuals and private organizations. Gifts and grants may be restricted either for specific operating purposes or for capital purposes.

(i) Restricted Resources

When UIHC has both restricted and unrestricted resources available to finance a particular program, it is UIHC's policy to use restricted resources before unrestricted resources.

(j) Net Position

Net position of UIHC is classified in four components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. Net position restricted by

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donors for specific purposes is noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to UIHC. Net position restricted for debt service is amounts deposited with trustees as required by bond indentures. Unrestricted net position is remaining net position that do not meet the definition of net investment in capital assets or restricted.

(k) *Operating Revenues and Expenses*

UIHC's statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing healthcare services – UIHC's principal activity. Nonexchange revenues, including investment income and gifts received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs.

(l) *Net Patient Service Revenue*

UIHC has agreements with third-party payors that provide for payments to UIHC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

(m) *Charity Care*

UIHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because UIHC does not pursue collection of amounts once determined to qualify as charity care, they are not reported as revenues in the accompanying statements of revenues, expenses, and changes in net position.

(n) *Compensated Absences*

UIHC employees accumulate vacation and sick leave under the provisions of the Code of Iowa. Under the state's policy, accrued vacation benefits are paid at an employee's regular hourly rate when used or are paid upon retirement, death, or termination with certain exceptions. Sick leave is paid in a similar manner when used or to a maximum of \$2,000 upon retirement. These benefits are accrued in the financial statements as earned by UIHC employees.

Retirement benefits are provided to employees primarily through a defined-contribution retirement plan sponsored by the University. UIHC funds its obligation to the retirement plan on a current basis, as earned by its employees.

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(o) Income Taxes

UIHC, as part of the University, is exempt from federal income taxes, pursuant to Section 115 of the Internal Revenue Code. As such, UIHC is subject to income taxes only on unrelated business income under the provisions of Section 511 of the Internal Revenue Code.

(p) Reclassifications

Certain reclassifications were made to 2012 balances to conform to 2013 presentation.

(2) Deposits and Investments

In accordance with Chapter 12B.10A, Section 5d of the Code of Iowa, the University's portfolios may be invested in obligations of the U.S. government and its agencies, certificates of deposit, prime bankers' acceptances, investment grade commercial paper, repurchase agreements, investments authorized by the Iowa Public Employees' Retirement System (IPERS) in Section 97B.7 of the Code of Iowa, investment grade corporate debt, mortgage pass-through and asset-backed securities with an A rating at time of purchase, an open-end management investment company organized in trust form registered with the S.E.C. under the Investment Company Act of 1940, the Common Fund for nonprofit organizations, and common stocks.

UIHC's cash and investments include specific investments and amounts pooled with cash and investments of the University and held in the University's name. UIHC's cash deposits at June 30, 2013 and 2012 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. Chapter 12C provides for additional assessments against the depositories of the pool to ensure that there will be no loss of public funds.

Noncurrent cash and investments limited by bond resolutions or designated by the Board were held for the following purposes at June 30, 2013 and 2012 (in thousands):

	2013	2012
Limited by bond resolutions:		
Debt service reserve	\$ 27,367	14,704
Unspent bond proceeds	158,606	24,907
Designated by the Board of Regents:		
Capital projects and equipment and other needs	432,910	417,037
Surplus	459	929
Improvement, extension, repair, operation, and maintenance funds	155,164	145,846
Restricted by donors	7,054	4,496
	\$ 781,560	607,919

Funds for improvement, extension, repair, operation, and maintenance shall be used to pay costs of operating and maintaining the hospital system whenever other funds are not sufficient and for improvements, extensions, and repairs. Noncurrent cash and investments include designated assets set

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aside by the Board for future facility infrastructure improvements, equipment, and technological needs, over which UIHC retains control and may, at its discretion, subsequently authorize its use for other purposes. The funds are invested in investment pools with allocations to equities, fixed income, real assets and liquidity asset classes.

Cash and cash equivalents and short-term investments specifically identified or pooled with the cash and investments of the University totaled \$153.6 million and \$145.8 million at June 30, 2013 and 2012, respectively. Cash equivalents designated by the Board totaled \$237.5 million and \$140.9 million at June 30, 2013 and 2012, respectively.

UIHC's investments are recorded at fair value, as determined by quoted market price. As of June 30, 2013, UIHC had the following investments and quality credit ratings (in thousands):

<u>Fixed income</u>	<u>Effective duration (years)</u>	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>BB</u>	<u>B</u>	<u>N/A</u>	<u>Total market value</u>
Corporate notes and bonds	3.28	\$ 1,183	383	1,312	826	—	—	—	3,704
U.S. government agencies	3.08	26,812	690	—	—	—	—	11	27,513
U.S. Treasury obligations	4.66	25,090	—	—	—	—	—	—	25,090
Mutual funds	6.68	55,759	172,605	15,188	—	2,270	29,955	—	275,777
		<u>\$ 108,844</u>	<u>173,678</u>	<u>16,500</u>	<u>826</u>	<u>2,270</u>	<u>29,955</u>	<u>11</u>	332,084
Other investments:									
Cash and cash equivalents									\$ 391,149
U.S. equity mutual funds									67,137
Non-U.S. equity mutual funds									28,687
REIT mutual funds									26,186
Real assets									10,997
Private equity									1,692
Repurchase agreement									74,191
Certificates of deposit									4,787
Total investments									<u>\$ 936,910</u>

As of June 30, 2012, UIHC had the following investments and quality credit ratings (in thousands):

<u>Fixed income</u>	<u>Effective duration (years)</u>	<u>TSY/AGY/NA</u>	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB+</u>	<u>BB</u>	<u>B</u>	<u>Total market value</u>
Corporate notes and bonds	3.88	\$ 17	1,286	344	1,836	1,301	89	—	4,873
U.S. government agencies	2.36	9,551	65	21,007	—	85	—	—	30,708
U.S. Treasury obligations	4.33	26,188	—	—	—	—	—	—	26,188
Mutual funds	5.68	—	61,048	166,694	14,496	—	2,232	29,335	273,805
		<u>\$ 35,756</u>	<u>62,399</u>	<u>188,045</u>	<u>16,332</u>	<u>1,386</u>	<u>2,321</u>	<u>29,335</u>	335,574
Other investments:									
Cash and cash equivalents									\$ 286,671
U.S. equity mutual funds									61,697
Non-U.S. equity mutual funds									26,601
REIT mutual funds									28,066
Real assets									10,246
Private equity									1,538
Certificates of deposit									4,853
Total investments									<u>\$ 755,246</u>

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Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. This risk is measured using effective duration. At time of purchase, the effective maturity of direct investment purchases by the University in the operating portfolio cannot exceed sixty-three months. There is no explicit limit on the average maturity of fixed income securities in the endowment portfolios. Each fixed income portfolio is managed to an appropriate benchmark.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation to the University. The University manages exposure to credit risk by measuring portfolios against benchmarks as established by the Board. As of June 30, 2013, the operating portfolio benchmark and the long-term bond portfolio benchmark is AA1 (Barclays Capital Aggregate Bond Index).

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of investments in a single issuer. Except for Treasury or Agency debentures, pass-throughs or REMICs, no more than 5% of University investment portfolios are invested in securities of a single issuer. All direct investment purchases by the University in the operating portfolio are U.S. Treasury and agency securities.

Foreign Currency Risk – Foreign currency risk is the risk of an investment's value changing due to changes in currency exchange rates. The University's investment policy does not allow direct investment in foreign currencies. Also, no more than 30% of the long-term endowment portfolio can be invested in non-U.S. securities.

(3) Capital Assets

Capital assets at June 30, 2013 and 2012 are summarized as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Land	\$ 15,596	13,684
Land improvements	925	782
Infrastructure	47,890	42,104
Buildings and leasehold improvements	847,328	766,284
Equipment	321,275	307,219
Software	81,736	79,621
Construction in progress (nondepreciable)	102,904	98,255
	<u>1,417,654</u>	<u>1,307,949</u>
Less accumulated depreciation	<u>782,869</u>	<u>741,903</u>
	<u>\$ 634,785</u>	<u>566,046</u>

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Capital asset additions, retirements, and balances as of and for the years ended June 30, 2013 and 2012 were as follows (in thousands):

<u>Cost basis summary</u>	<u>June 30, 2012 balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2013 balances</u>
Land (nondepreciable)	\$ 13,684	1,912	—	15,596
Land improvements	782	143	—	925
Infrastructure	42,104	5,786	—	47,890
Buildings and leasehold improvements	766,284	81,044	—	847,328
Equipment and software	386,840	50,674	(34,503)	403,011
Construction in progress (nondepreciable)	98,255	70,237	(65,588)	102,904
	<u>1,307,949</u>	<u>209,796</u>	<u>(100,091)</u>	<u>1,417,654</u>
Total at historical cost				
Less accumulated depreciation for:				
Land improvements	746	13	—	759
Infrastructure	38,228	1,432	—	39,660
Buildings and leasehold improvements	471,270	29,948	—	501,218
Equipment and software	231,659	41,278	(31,705)	241,232
	<u>741,903</u>	<u>72,671</u>	<u>(31,705)</u>	<u>782,869</u>
Total accumulated depreciation				
Total capital assets, net	<u>\$ 566,046</u>	<u>137,125</u>	<u>(68,386)</u>	<u>634,785</u>

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<u>Cost basis summary</u>	<u>June 30, 2011 balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2012 balances</u>
Land (nondepreciable)	\$ 13,684	—	—	13,684
Land improvements	782	—	—	782
Infrastructure	41,591	649	(136)	42,104
Buildings and leasehold improvements	730,538	35,746	—	766,284
Equipment and software	373,790	44,363	(31,313)	386,840
Construction in progress (nondepreciable)	48,544	93,365	(43,654)	98,255
Total at historical cost	<u>1,208,929</u>	<u>174,123</u>	<u>(75,103)</u>	<u>1,307,949</u>
Less accumulated depreciation for:				
Land improvements	743	3	—	746
Infrastructure	37,156	1,072	—	38,228
Buildings and leasehold improvements	441,619	29,651	—	471,270
Equipment and software	222,054	38,998	(29,393)	231,659
Total accumulated depreciation	<u>701,572</u>	<u>69,724</u>	<u>(29,393)</u>	<u>741,903</u>
Total capital assets, net	<u>\$ 507,357</u>	<u>104,399</u>	<u>(45,710)</u>	<u>566,046</u>

At June 30, 2013, construction in progress is related to various projects throughout the UIHC. The estimated cost to complete the current phase of equipment and projects under construction at June 30, 2013 is \$223.7 million. Other projects at June 30, 2013, with an estimated cost of \$934.3 million, have been committed to by the Board and/or UIHC; however, construction contracts had not been signed as of such date. These projects are anticipated to be funded through existing designated funds, cash provided by future operations, and/or the issuance of additional long-term debt.

Cost of capital assets includes interest during the construction period for qualifying projects. Interest costs capitalized for the years ended June 30, 2013 and 2012 were \$5.6 million and \$2.9 million, respectively.

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(4) Long-Term Debt

Long-term debt outstanding at June 30, 2013 and 2012 was as follows (in thousands):

	2013	2012
Hospital Revenue Bonds:		
Series S.U.I. 2007 – 4.375% to 5.500%; maturing serially on September 1 through 2027	\$ 20,775	21,750
Series S.U.I. 2007A – 4.000% to 5.500%; maturing serially on September 1 through 2027	20,800	21,725
Series S.U.I. 2009 – 5.500% to 6.125%; maturing serially on September 1 through 2028	29,075	30,250
Series S.U.I. 2010 – 3.000% to 4.500%; maturing serially on September 1 through 2037	29,250	30,000
Series S.U.I. 2011 – 2.000% to 4.000%; maturing serially on September 1 through 2032	26,800	26,800
Series S.U.I. 2011A – 2.000% to 4.125%; maturing serially on September 1 through 2028	19,310	20,355
Series S.U.I. 2012 – 4.000% to 4.000%; maturing serially on September 1 through 2038	190,000	—
Net unamortized premium on Hospital Revenue Bonds	14,124	1,326
Telecommunications Facilities Revenue Bonds:		
Series S.U.I. 2003 – 3.650% to 3.650%; maturing serially on July 1 through 2013	112	220
Series S.U.I. 2008 – 3.100% to 3.375%; maturing serially on July 1 through 2015	1,426	1,966
Series S.U.I. 2009 – 3.000% to 4.250%; maturing serially on July 1 through 2036	12,489	12,825
Series S.U.I. 2011 – 2.000% to 4.500%; maturing serially on July 1 through 2032	7,571	7,571
Total long-term bonds	371,732	174,788
Capital lease obligation	21,313	—
Total long-term debt	393,045	174,788
Long-term debt, current portion	8,133	5,818
	\$ 384,912	168,970

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Activity in long-term debt for the years ended June 30, 2013 and 2012 was as follows (in thousands):

	<u>June 30, 2012</u> balance	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2013</u> balance	<u>Amounts due</u> <u>within</u> <u>one year</u>
Hospital Revenue Bonds, Series 2007	\$ 21,750	—	(975)	20,775	1,025
Hospital Revenue Bonds, Series 2007A	21,725	—	(925)	20,800	950
Hospital Revenue Bonds, Series 2009	30,250	—	(1,175)	29,075	1,250
Hospital Revenue Bonds, Series 2010	30,000	—	(750)	29,250	775
Hospital Revenue Bonds, Series 2011	26,800	—	—	26,800	950
Hospital Revenue Bonds, Series 2011A	20,355	—	(1,045)	19,310	955
Hospital Revenue Bonds, Series 2012	—	190,000	—	190,000	—
Net unamortized bond premium	1,326	13,516	(718)	14,124	25
Telecommunications Facilities Revenue Bonds:					
Series 2003	220	—	(108)	112	112
Series 2008	1,966	—	(540)	1,426	556
Series 2009	12,825	—	(336)	12,489	339
Series 2011	7,571	—	—	7,571	282
Total long-term bonds	\$ 174,788	203,516	(6,572)	371,732	7,219
Capital lease obligations	—	22,000	(687)	21,313	914
Total long-term debt	\$ <u>174,788</u>	<u>225,516</u>	<u>(7,259)</u>	<u>393,045</u>	<u>8,133</u>

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	<u>June 30, 2011 balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2012 balance</u>	<u>Amounts due within one year</u>
Hospital Revenue Bonds, Series 2002	\$ 20,535	—	(20,535)	—	—
Hospital Revenue Bonds, Series 2007	22,675	—	(925)	21,750	975
Hospital Revenue Bonds, Series 2007A	22,600	—	(875)	21,725	925
Hospital Revenue Bonds, Series 2009	31,375	—	(1,125)	30,250	1,175
Hospital Revenue Bonds, Series 2010	30,000	—	—	30,000	750
Hospital Revenue Bonds, Series 2011	—	26,800	—	26,800	—
Hospital Revenue Bonds, Series 2011A	—	20,355	—	20,355	1,045
Net unamortized bond premium	1,189	819	(682)	1,326	(35)
Telecommunications Facilities Revenue Bonds:					
Series 2000	595	—	(375)	220	108
Series 2008	2,488	—	(522)	1,966	539
Series 2009	12,825	—	—	12,825	336
Series 2011	7,571	—	—	7,571	—
Total long-term debt	<u>\$ 151,853</u>	<u>47,974</u>	<u>(25,039)</u>	<u>174,788</u>	<u>5,818</u>

Long-term bonds

The Hospital Revenue Bonds are special obligations of the Board payable solely out of Hospital Income, the general purpose of which is to expand and improve UIHC facilities. “Hospital Income” is defined as the gross income and funds received by the Hospital System at the University, including the proceeds of rates, fees, charges, and payments for healthcare provider activities for patient care services rendered by the University’s hospitals, clinics, laboratories, and ancillary facilities, less current expenses (as defined in the resolution authorizing the issuance of the bonds, the Bond Resolution). Hospital Income does not include state appropriations to the University or IowaCare appropriations to the Hospital System. So long as the bonds or parity bonds remain outstanding, the entire Hospital Income shall be deposited to the revenue fund and shall be disbursed to the following funds in the following order: (1) the operation and maintenance fund, (2) the sinking fund, (3) the reserve fund, and (4) the system fund. The reserve fund requirement is at least equal to the maximum annual amount of the principal and interest coming due on the bonds and any parity bonds, or \$25.3 million. The maximum amount of Hospital Income pledged representing the undiscounted principal and interest on the bonds is \$550.9 million.

The Telecommunications Facilities Revenue Bonds (Telecommunications Bonds) represent UIHC’s share of the remaining outstanding bonds that were issued by the University to pay costs of constructing and installing communications facilities and equipment on the University’s campus. No specific revenue stream of UIHC has been pledged to service the Telecommunications Bonds. Monthly payments are

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required to be made to various sinking funds for payment of principal and interest. A portion of the monthly payments is supported by UIHC.

Scheduled principal and interest payments on the bonds for the next five years and five-year increments thereafter are as follows (in thousands):

	<u>Principal</u>	<u>Interest</u>
Year(s) ending June 30:		
2014	\$ 7,219	14,569
2015	12,409	14,205
2016	12,447	13,728
2017	12,544	13,235
2018	12,915	12,723
2019 through 2023	71,798	55,377
2024 through 2028	86,892	38,712
2029 through 2033	67,418	21,776
2034 through 2038	62,018	8,710
2039	11,973	240
	<u>\$ 357,633</u>	<u>193,275</u>

Capital Lease Obligations

The following is a schedule by year of future minimum payments required:

	<u>Principal</u>	<u>Interest</u>
Year(s) ending June 30:		
2014	\$ 914	629
2015	941	602
2016	969	574
2017	998	545
2018	1,027	516
2019 through 2023	5,609	2,354
2024 through 2028	6,486	2,084
2029 through 2031	4,369	441
	<u>\$ 21,313</u>	<u>7,745</u>

(5) Retirement Benefit Plans

Substantially all UIHC employees meeting eligibility requirements participate in the University of Iowa Retirement Plan (the Plan). The Plan is a defined-contribution retirement plan providing benefits through the Teachers Insurance and Annuity Association and the College Retirement Equity Fund (TIAA-CREF). UIHC contributions to the Plan are 10% of employee compensation after the first five years of employment. During the first five years of employment, UIHC's contribution is 6.67% of the first \$4,800

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of compensation and 10% of the balance of employee compensation. Employees are required to contribute an amount equal to 50% of UIHC's contribution. All contributions to the Plan are immediately 100% vested.

Eligible employees not electing to participate in the Plan are required to participate in the Iowa Public Employees' Retirement System (IPERS), a multiple employer, cost-sharing public employees' retirement system.

The University internally accounts for employee benefits using a benefits pool. Each department, including UIHC, is assessed a total amount to be paid into the pool covering all employee benefits, which approximated \$33.6 million and \$33.0 million for contributions to TIAA-CREF and IPERS in 2013 and 2012, respectively.

(6) Health Insurance Benefits for Retirees

Other postemployment benefits (OPEB) are recorded in the financial statements as noncurrent accrued payroll on the statements of net position and are included as an operating expense in salaries and benefits on the statements of revenues, expenses, and changes in net position.

All UIHC employees meeting eligibility requirements participate in the University of Iowa Health Insurance Benefits for Retirees. The University of Iowa's defined-benefit postemployment healthcare plan provides medical and dental benefits to eligible retired employees, which include employees who retire from the University after attaining age 55 and before reaching age 62, or who retire after attaining age 62 with 10 or more years of service.

The contribution requirements of plan members and the University are established and may be amended by the Board. The terms and conditions governing the postemployment benefits to which employees are entitled are in the sole authority and discretion of the University's Board. For fiscal years 2013 and 2012, UIHC's allocated annual OPEB cost was \$7.7 million and \$9.3 million, respectively, of which \$3.8 million was contributed to the plan in 2013 and \$4.7 million in 2012. The net allocated OPEB obligation at June 30, 2013 and 2012 was \$23.7 million and \$20.3 million, respectively. Although there is no requirement to fund the OPEB liability, the University has chosen to fund it on a "pay-as-you-go" basis. University policy dictates the payment of retiree claims as they become due. Plan members receiving benefits contributed 51% and 49% of the premium costs in fiscal years 2013 and 2012, respectively. In fiscal years 2013 and 2012, total member contributions were \$3.9 million and \$4.6 million, respectively.

The University's defined-benefit postemployment healthcare plan does not issue a separate financial report, but is included in the University's annual report, which can be obtained at the University of Iowa, 4 Jessup Hall, Iowa City, Iowa 52242.

(7) Risk Management

The University, or the State of Iowa on behalf of UIHC, self-insures workers' compensation, unemployment, medical, and dental benefits for eligible employees, automobile liability, professional liability, and general liability. UIHC pays the employer portion of the costs related to workers' compensation, unemployment, and medical and dental benefits. UIHC purchases commercial property

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insurance for its facilities, including business interruption insurance. UIHC also purchases commercial life and disability insurance for eligible employees as part of the University's benefit program.

UIHC's portion of the health insurance liability, which is included in accounts payable and accrued expenses, is \$4.2 million and \$4.0 million as of June 30, 2013 and 2012, respectively, as follows (in thousands):

	2013	2012
Liability for unpaid healthcare claims at beginning of year	\$ 4,028	4,148
Healthcare expenses incurred during the year	59,997	54,538
Healthcare payments to the University during the year	(59,781)	(54,658)
Liability for unpaid healthcare claims at end of year	\$ 4,244	4,028

The University of Iowa and other Board of Regents institutions are self-insured for automobile liability up to \$250,000. Losses in excess of \$250,000 are paid by the State of Iowa, as provided in Chapter 669 of the Code of Iowa.

UIHC is an agency of the State of Iowa and is covered by the State's self-insurance for tort liability. Tort claims against the State are handled as provided in the Iowa Tort Claims Act (Iowa Code, Chapter 669) which also sets forth the procedures by which tort claims may be brought. Claims under Chapter 669 may be filed against the State on account of wrongful death, personal injury or property damage incurred by reason of the negligence of the UIHC or its employees while acting within the scope of employment. By inter-agency agreement, tort liability claims under \$5,000 may be administered by the UIHC subject to a maximum expenditure of \$100,000 per year. All other tort claims may be paid from the State's general fund.

The State maintains an employee fidelity bond where the first \$100,000 in losses is the responsibility of UIHC. Under the State coverage, losses in excess of the \$100,000 deductible are insured up to \$2,000,000. The University maintains separate fidelity and crime coverage, which extends to all employees, and includes coverage for robbery and theft. The University's bond provides an additional \$8,000,000 in coverage over the state bond.

(8) Transactions with Related Parties

UIHC receives certain administrative services, utilities, and other general services from the University. The services and support costs include amounts due to the University's Carver College of Medicine for support of graduate medical education, specific clinical services, and other services. These services are charged to UIHC at the approximate cost incurred by the servicing unit. For the years ended June 30, 2013 and 2012, UIHC expensed approximately \$146.3 million and \$135.6 million, respectively, for these administrative services, utilities, and other services and support requirements. At June 30, 2013, approximately \$1.3 million was due from the Carver College of Medicine, and at June 30, 2012, \$0.9 million was due to the Carver College of Medicine. At June 30, 2013 and 2012, \$3.3 million and \$3.2 million, respectively, was due to the University of Iowa for services and support.

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UIHC also provides certain administrative services to units of the University. These services include billing, collection, and other physician practice-related clinic overhead expenses. These services are charged to units of the University at the approximate cost incurred by the servicing unit. For the years ended June 30, 2013 and 2012, UIHC received revenue from these units of approximately \$32.9 million and \$31.3 million, respectively, for these services.

UIHC transfers to and receives transfers from Non-UIHC University of Iowa units. Net transfers to these units totaled \$46.7 million and \$15.5 million for the years ended June 30, 2013 and 2012, respectively.

UIHC and the College of Medicine have formed a nonprofit corporation, UIHS, to enhance and support the educational missions of the UIHC and the College of Medicine, particularly as these missions apply to clinical activities and statewide and multistate network development activities. UIHC paid UIHS for certain administrative and other general services in the amount of \$1.4 million and \$1.6 million for the years ended June 30, 2013 and 2012, respectively.

(9) Net Patient Service Revenue

Net patient service revenue, as reflected in the accompanying statements of revenues, expenses, and changes in net position, consists of the following (in thousands):

	2013	2012
Gross patient charges:		
Inpatient charges	\$ 1,441,485	1,373,372
Outpatient charges	1,404,324	1,264,562
Total gross patient charges	2,845,809	2,637,934
Less deductions from gross patient charges:		
Contractual adjustments – Medicare, Medicaid, and other	1,748,645	1,570,765
Provision for bad debt	24,940	25,990
Net patient service revenue	\$ 1,072,224	1,041,179

The provision for uncollectible patient accounts is based upon UIHC's management's assessment of expected net collections considering the accounts receivable aging, historical collections experience, economic conditions, trends in healthcare coverage, and other collection indicators. Management periodically assesses the adequacy of the allowances for uncollectible accounts and contractual adjustments based upon historical write-off experience. The results of these reviews are used to establish the net realizable value of patient accounts receivable. UIHC follows established guidelines for placing certain patient balances with collection agencies. Self-pay accounts are written off as bad debt at the time of transfer to the collection agency. Deductibles and coinsurance are classified as either third-party or self-pay receivables on the basis of which party has the primary remaining financial responsibility, while the total gross revenue remains classified based on the primary payor at the time of service. Net patient accounts receivable have been adjusted to the estimated amounts expected to be collected.

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Patient service revenue (net of contractual allowances and discounts but before the provision for bad debts), recognized in 2013 from these major payor sources, is as follows:

	2013	2012
Patient (self-pay)	\$ 31,545	31,370
Less provision for bad debt	24,940	25,990
Self-pay (net of contractual allowance, discounts, and provision for bad debts)	6,605	5,380
Medicaid	172,508	165,999
Medicare	286,719	268,254
Commercial insurance and other third-party payors	606,392	601,546
Patient service revenue (net of contractual allowance, discounts, and provision for bad debts)	\$ 1,072,224	1,041,179

UIHC has agreements with third-party payors that provide for payments to UIHC at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

(a) Medicare

Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

(b) Iowa Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are primarily paid at prospectively determined rates per discharge. Physician clinical services are paid based on fee schedule amounts.

Revenue from Medicare and Medicaid programs accounted for approximately 27% and 16%, respectively, of UIHC's net patient revenue for the year ended 2013, and 26% and 16%, respectively, of UIHC's net patient revenue for the year ended 2012. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The 2013 net patient service revenue decreased approximately \$2.2 million due to prior year retroactive adjustments in excess of amounts previously estimated. 2012 net patient service revenue increased approximately \$3.3 million due to prior year retroactive adjustments in excess of amounts previously estimated.

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(c) IowaCare

The IowaCare program serves people between the ages of 19 and 64 with income up to 200% of the federal poverty level who do not have other sources of healthcare coverage. This program was initially approved by the Centers for Medicare and Medicaid Services (CMS) as a Section 1115 Medicaid demonstration program to operate from July 1, 2005 through June 30, 2010. CMS has subsequently reauthorized the IowaCare program through December 31, 2013. Inpatient and outpatient services rendered to IowaCare program beneficiaries are primarily paid at prospectively determined rates per discharge. The amount of revenue UIHC received for this program in 2013 and 2012 was \$79.9 million and \$71.5 million, respectively.

(d) Commercial

UIHC has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to UIHC under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

(10) Charity Care and Uncompensated Cost of Services

UIHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Certain accounts are classified as charity care and, therefore, are not reported as revenue. Charges forgone for services and supplies furnished under UIHC's charity policy for the years ended June 30, 2013 and 2012 are as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Charity care	\$ 26,938	23,774
Charity care for state institution patients	6,003	4,876
Charity care charges forgone	<u>\$ 32,941</u>	<u>28,650</u>

UIHC also provides reduced price services and free programs throughout the year. The total uncompensated costs of services other than charity care, for the years ended June 30, 2013 and 2012, approximate the following (in thousands):

	<u>2013</u>	<u>2012</u>
Medicare	\$ 22,266	23,432
Medicaid	12,608	10,467
Medicaid out of state	691	1,606
IowaCare	36,249	25,279
Uncompensated costs of services	<u>\$ 71,814</u>	<u>60,784</u>

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(11) Concentrations of Credit Risk

UIHC grants credit without collateral to its patients, most of whom are Iowa residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2013 and 2012 was as follows:

	<u>2013</u>	<u>2012</u>
Blue Cross/Blue Shield	27%	27%
Commercial pay	27	27
Medicare	22	19
Medicaid	12	13
IowaCare	6	7
Self-pay	4	4
Other	2	3
	<u>100%</u>	<u>100%</u>

(12) Operating Leases

UIHC uses certain capital assets under noncancelable operating leases. In most cases, management expects that, in the normal course of operations, the leases will be renewed or replaced by other leases. Total rent expense under operating leases for the years ended June 30, 2013 and 2012 was \$6.1 million and \$4.6 million, respectively.

The following is a schedule by year of future minimum rental payments required under noncancelable operating leases as of June 30, 2013 (in thousands):

Year ending June 30:	
2014	\$ 2,649
2015	1,795
2016	626
2017	572
2018	473
Thereafter	<u>471</u>
Total minimum payments required	<u>\$ 6,586</u>

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(13) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses reported as current liabilities at June 30, 2013 and 2012 consisted of the following amounts (in thousands):

	2013	2012
Payable to employees (including payroll taxes)	\$ 79,059	75,010
Payable to suppliers	32,981	37,121
Other	4,287	5,057
Total accounts payable and accrued expenses	\$ 116,327	117,188

(14) Law and Regulations

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that UIHC is in compliance with government laws and regulations as they apply to the areas of fraud and abuse. While no regulatory inquiries have been made that are expected to have a material effect on UIHC's financial statements, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory action unknown or unasserted at this time.

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in 2011 to certain hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology in ways that demonstrate improved quality and effectiveness of care. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. An initial Medicaid incentive payment is available to providers that adopt, implement, or upgrade certified EHR technology. However, in order to receive additional Medicaid incentive payments in subsequent years, providers must demonstrate continued meaningful use of EHR technology.

The University of Iowa Hospitals and Clinics accounts for meaningful use incentive payments as a nonexchange transaction. Medicare EHR incentive payments are recognized as revenues when eligible providers demonstrate meaningful use of certified EHR technology and the cost report information for the full cost report year that will determine the full calculation of the incentive payment is available. Medicaid EHR incentive payments are recognized as revenues when an eligible provider demonstrates meaningful use of certified EHR technology. During the years ended June 30, 2013 and 2012, UIHC recognized \$2.6 million and \$3.4 million, respectively, of Medicare meaningful use revenues and \$3.6 million and \$6.0 million, respectively, of Medicaid meaningful use revenues in its statements of revenues, expenses, and changes in net position.

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(15) Subsequent Events

UIHC has reviewed subsequent events through November 8, 2013, the date the financial statements were available to be issued, and concluded that there were no events or transactions during this period that would require recognition or disclosure in the financial statements other than those already disclosed.